



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

501-03.00

Date: March 14, 2013

Release Number: 201329018

Release Date: 7/19/2013

LEGEND

ORG - Organization name

XX - Date Address - address

Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:
(Phone)
(Fax)

ORG
ADDRESS

CERTIFIED MAIL - RETURN RECEIPT

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code. Our favorable determination letter to you dated July 28, 20XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals. Treas. Reg. 1.501(c)(3)-1(a)(1). You failed to respond to repeated reasonable requests to allow the Internal Revenue Service to examine your records regarding your receipts, expenditures, or activities and have failed to file information returns for 2010 and 2011, as required by I.R.C. 6001, 6033(a)(1) and Rev. Rul. 59-95, 1959-1 C.B. 627.

Further, your primary activity and purpose during 20XX and subsequent years appears to consist of the operation of bingo games, which in and of themselves, do not further an exempt purpose and comprise more than an insubstantial amount of your activities. Your bingo receipts arose primarily in the operation of instant bingo games, which comprises an unrelated trade or business. An organization is not operated exclusively for exempt purposes if it is operated primarily for the purpose of carrying on an unrelated trade of business as defined in I.R.C. 513. Treas. Reg. 1.501(c)(3)-1(e).

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

**Nanette M. Downing
Director, EO Examinations**

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
55 N. Robinson MC 4900 OKC
Oklahoma City, OK 73102

Department of the Treasury

Date: September 7, 2012

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

Certified Mail – Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for

the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	990 & 990-T	Tax Identification Number EIN	Year/Period ended 20XX12 20XX12 20XX12

LEGEND

ORG - Organization name EIN - ein XX - Date State - state Motto - motto
Game - game Co-1 - 1st COMPANY

Issue 1

1. Whether ORG did operate exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3) for the years under exam.

- Whether ORG did operate for the primary purpose of carrying on a trade or business for profit.
- Whether more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose?
- Whether ORG failed to file Form 990 Return of Organization Exempt From Income Tax for tax years ending December 31, 20XX and December 31, 20XX.

Facts

ORG, hereinafter referred to as "ORG" was established as a nonprofit organization on August 15, 20XX. In a determination letter dated July 28, 20XX the Internal Revenue Service determined "ORG" to be exempt from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code.

In its Articles of Association, "ORG" states the entity is organized to perform activities within the meaning of Internal Revenue Code Section 501(C)(3) and specifically this Entity is organized to support the Fine Arts in the State of State and this United States.

Reported Financial Information on Form 990 20XX12

Part I Summary

Contributions \$\$

Part III Gaming.

		(a) Motto	(b) Pull tabs/Game/progressi ve Motto	(c) Other gaming	(d) Total gaming (add col. (a) through col. (c))

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Revenue	1. Gross Revenue	\$			\$	
	Direct Expenses	2. Cash Prizes	\$			\$
3. Noncash prizes						
4. Rent/facility costs		\$			\$	
5. Other direct expenses		\$			\$	
		<input type="checkbox"/> Yes %	<input type="checkbox"/> Yes %			
	6. Volunteer labor	X No	X No			
	7. Direct expense summary. Add lines 2 through 5 in column (d)					\$
	8. Net gaming income summary. Combine line 1, column (d), and line 7					(\$)

Non-Filing of Form 990 Return of Organization Exempt From Income Tax

"ORG" did not file Form 990 Return of Organization Exempt From Income Tax for tax years ending December 31, 20XX or December 31, 20XX.

Non Exempt Activity Description

"ORG" did not perform any exempt activities for the years of audit. "ORG" did make contributions for scholarships in the amount of \$\$ for tax year ending December 31, 20XX. The primary activity "ORG" conducted for tax year ending December 31, 20XX was Game. Game is reported on Form 990-T as unrelated income subject to the Unrelated Business Income Tax. "ORG" did file Form 990-T Exempt Organization Business Income Tax Return for tax year ending December 31, 20XX showing unrelated business income to be zero. "ORG" did not file Form 990-T Exempt Organization Business Income Tax Return for tax years ending December 31, 20XX or December 31, 20XX. All MOTTO activity was conducted with paid workers.

Note: State of State requires MOTTO licensed holders to make contributions to charities in order to maintain their license.

Gaming Activities – General

"ORG" obtained from the State of State a license to conduct Motto and was a member of CO-1 for the periods of examination.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	990 & 990-T	Tax Identification Number EIN	Year/Period ended 20XX12 20XX12 20XX12

The CO-1 is required to file quarterly reports with the State of State in order to maintain it's license to conduct Motto.

The CO-1 (hereinafter the CO-1), organized January 1, 20XX in the State of State and is made up of this organization and four other exempt organizations. The trust agreement was amended August 18, 20XX in order to admit one more exempt organization as an additional Beneficiary (member) of the CO-1. The revenue and expenses for these six organizations are consolidated and reported to the State of State on one quarterly Motto Report (filed by the CO-1). According to the Units Amendment to Trust Agreement, the proceeds and expenses of the CO-1 are apportioned to each Beneficiary according to the number of sessions each organization conducts per quarter. The CO-1 distributes, at least quarterly, net income (or loss) among the Beneficiaries. Copies of the CO-1 Agreement and Amendments are attached;
(See Exhibit 1 and Exhibit 2.)

CO-1 Trust filed State Motto Quarterly Reports for 20XX through 20XX. (Attached are 20XX all quarters; 20XX all quarters and 20XX 1st, 2nd and 3rd quarter)

"ORG" did not report the gross receipts from "Game Motto", which were allocated to the organization by the CO-1, as unrelated business income on the 20XX; 20XX or 20XX Form 990-T Exempt Organization Business Income Tax Return. "ORG" filed Form 990-T, Exempt Organization Business Income Tax Return for tax year ending December 31, 20XX reporting unrelated business income of zero. "ORG" did not file Form 990-T, Exempt Organization Business Income Tax Return for tax years ending December 31, 20XX or December 31, 20XX.

A **Game** is a gambling ticket that is sold as a means to play a **Game game**. The object of the ticket is to open the perforated windows on the back of the ticket and match the symbols inside the ticket to the winning combinations on the front of the ticket. The winning Game ticket is turned in for a monetary prize. Other names for it include Game, Game, Game, Game, Game, Game, Game, or Game.

The game manager operates the game by selling tickets and distributing cash prizes. The tickets may also be provided by mechanical Game dispensers. The Game tickets are multi-layered paper tickets containing symbols hidden behind perforated tabs. Several different games may be offered for sale at any one time; each may have different prices and payouts. Games are typically sold for ¢, ¢, \$ and \$ and have prizes as high as \$.

Each ticket has two sides. One side lists the winning combinations of symbols, the cash payout for each combination, the number of tickets that contain each winning combination, and the total number of tickets in the game. This information is also posted in a large printed sheet called a flare.

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The other side of the ticket contains the perforated tabs. After purchasing the ticket, the player pulls the perforated tabs to reveal their winnings, if any. Cash prizes may be claimed immediately.

Motto Event Games (also called ball games, last number, dab games, or tag-along games) bridge the gap between Motto and Games. Each individual Motto event ticket game has a number of instant winning tickets and a series of "hold" tickets. The "hold" tickets in a Motto event game are traditionally Motto numbers from B-1 to O-75. These "hold" tickets are held for a larger prize that is paid out after all the tickets are sold. Many styles are available.

Law

Issue 1

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax.

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Section 6001 of the Internal Revenue Code of 1986, as amended (the "Code"), provides that every person liable for any tax imposed by title 26, or for the collection thereof, shall keep such records, render such statements, make such returns and -comply with such rules and Regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by Regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under title 26.

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Section 1.6001-1(c) of the Regulations provides, in part, that organizations exempt from tax under section 501(a) shall "keep such books and records as are required to substantiate the information required by" section 6033.

Section 6033 provides, in general, that every organization exempt under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or Regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and Regulations as the Secretary may from time to time prescribe.

Section 1.6033-2(a)(1) of the Regulations provides, in part, that, except for certain exceptions not here applicable, every organization exempt from taxation under section 501(a) shall file an annual information return specifically setting forth its items of gross income, gross receipts and disbursements, and such other information as may be prescribed in the instructions issued with respect to the return.

Section 1.6033-2(1) (2) of the Regulations provides, in part, that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F, chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code.

Section 6652(c)(1) provides that in the case of a failure to file a return required under section 6033 on the date and in the manner prescribed therefore (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the exempt organization or trust failing so to file, \$20 for each day during which such failure continues, but the maximum amount imposed hereunder on any organization for failure to file any one return shall not exceed the lesser of \$10,000 or five (5) percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding \$1,000,000 for any year, there is a \$100 per day penalty for failure to file with a maximum penalty of \$50,000.

Section 6652(c)(2) provides that in the case of a failure to file returns required under section 6034 (relating to returns by certain trusts), or section 6043(b) (relating to terminations, etc. of exempt organizations), on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the exempt organization or trust failing so to file, \$10 for each day during which such failure continues, but the total amount imposed hereunder on any organization for failure to file any return shall not exceed \$5,000. Written demand may be made on organizations failing to file and if returns are not

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Name of taxpayer ORG	990 & 990-T	Tax Identification Number EIN	Year/Period ended 20XX12 20XX12 20XX12

filed by the date specified, similar penalties may be imposed upon managers or such organizations. I.R.C. § 6652(c)(2)(B).

Section 6033, Treas. Reg. § 1.6001-1(c) and Treas. Reg. § 1.6033-2(a) (1) and (i) (2) require any organization exempt from tax under section 501(a), to supply the Service with such information as is required by the revenue procedures and the instructions for Schedule A (Form 990) and to keep such books and records as are necessary to substantiate such information.

IRC § 502. Feeder organizations

(a) General rule.—An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

(b) Special rule.—For purposes of this section, the term “trade or business” shall not include—

- (2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or

Revenue Ruling 61-170, 1961-2 CB 112 ruled that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Revenue Ruling 70-4, 1970-1 CB 126 ruled that Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for educational purposes. Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

Taxpayer's Position

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Name of taxpayer ORG 990 & 990-T	Tax Identification Number EIN		Year/Period ended 20XX12 20XX12 20XX12

Taxpayer has not stated a position at this time.

Government's Position:

It is the Government's position that "ORG" is not operated as an organization described in section 501(c)(3) of the Internal Revenue Code. "ORG's" sole activity is MOTTO. MOTTO is not an exempt activity. In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

percent (939,063.67/1,405,134.49= % for tax year ending December 31, 20XX) and percent (741,203.22/1,098,625.00= % for tax year ending December 31, 20XX) and percent (657,047.41/927,92204= %) for tax year ending December 31, 20XX) of "ORG's" Gross Revenue is from Pull tabs/Game. Game is a trade or business for profit and is an unrelated exempt activity. "ORG" did not receive any contribution or grants for the years of exam. All MOTTO activity was conducted with paid workers. IRC 502 specifically provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under 501 on the ground that all of its profits are payable to organizations which do qualify under IRC 501.

Note: Examination revealed no exempt activity what so ever in year of exam.

In addition, "ORG" did not file Form 990 Return of Organization Exempt From Income Tax for tax years ending December 31, 20XX or December 31, 20XX as required under Internal Revenue Code 6033.

Conclusion:

"ORG" is not operating exclusively for purposes specified in IRC 501(C)(3) nor did "ORG" file Form 990 Return of Organization Exempt From Income Tax for tax years ending December 31, 20XX or December 31, 20XX as required under Internal Revenue Code 6033. "ORG" is not exempt from income tax under section 501, effective January 1, 20XX. In order to be treated as a 501(c)(3) the exempt organization must in operation perform an exempt activity related to it's exempt purpose. This organization during the years of exam performed no exempt activity and fails the operation test. Therefore; we propose revocation.

If you agree to the proposed revocation, please sign form 6018, and mail back to the person listed in the attached letter, within 30 days of receipt of this letter. If you do not agree to the proposed revocation please refer to the letter and attached publications for the appeals process, or contact the person listed in the letter.

If this proposed revocation is upheld, Form 1120 U.S. Corporation Income Tax Return should be filed for tax years ending beyond the date of revocation.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG 990 &	990-T	Tax Identification Number EIN	Year/Period ended 20XX12 20XX12 20XX12

ALTERNATIVE ISSUES:

In the alternative, if "ORG" continues to qualify for exemption under section 501(c)(3),

1. Is "ORG" subject to Section 511 Tax on Unrelated Business Income for income it received from conduct of "Game Motto"?
2. Whether a partner's distributive share of partnership income retains the same character as when the income was earned by the partnership.
3. Whether the expenses related to Motto and "Game Motto" should be allocated using a gross receipts method.

FACTS:

Gaming Activities – General

"ORG", hereinafter referred to as ("ORG") obtained from the State of State a license to conduct Motto and was a member of CO-1 for the periods of examination.

The CO-1 is required to file quarterly reports with the State of State in order to maintain it's license to conduct Motto.

The CO-1 (hereinafter the CO-1), organized January 1, 20XX in the State of State and is made up of this organization and four other exempt organizations. The trust agreement was amended August 18, 20XX in order to admit one more exempt organization as an additional Beneficiary (member) of the CO-1. The revenue and expenses for these six organizations are consolidated and reported to the State of State on one quarterly Motto Report (filed by the CO-1). According to the Units Amendment to Trust Agreement, the proceeds and expenses of the CO-1 are apportioned to each Beneficiary according to the number of sessions each organization conducts per quarter. The CO-1 distributes, at least quarterly, net income (or loss) among the Beneficiaries. Copies of the CO-1 Agreement and Amendments are attached;
(See Exhibits 1 and 2.)

The CO-1 filed State Motto Quarterly Reports for 20XX through 20XX. Attachments A-4 20XX; A-4 20XX and A-4 20XX show the amounts reported on the Quarterly Reports for the organizations tax years ending December 31, 20XX; December 31, 20XX and December 31, 20XX.

"ORG" did not report the gross receipts from "Game Motto", which were allocated to the organization by the CO-1, as unrelated business income on the 20XX; 20XX or 20XX Form 990-T Exempt Organization Business Income Tax Return. "ORG" filed Form 990-T, Exempt

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Section 513(a)(1) provides that the term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 513(f)(1) of the Code states in general.--The term "unrelated trade or business" does not include any trade or business which consists of conducting Motto games.

Section 513(f)(2) defines "Motto games" as any game of Motto of a type in which usually the wagers are placed, the winners are determined, and the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game, the conducting of which is not an activity ordinarily carried out on a commercial basis, and the conducting of which does not violate any State or local law.

Section 1.513-1(e)(1) of the Income Tax Regulations provides for exceptions to Section 513(a) of the Code, including any trade or business in which substantially all of the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.513-5(a) of the Regulations provides that, under Section 513(f) of the Code, and subject to the limitations in paragraph (c) of this Section, in the case of an organization subject to the tax imposed by Section 511, the term "unrelated trade or business" does not include any trade or business that consists of conducting Motto games as defined in paragraph (d) of this Section.

Section 1.513-5(c)(1) of the Regulations provides that paragraph (a) of this Section shall not apply with respect to any Motto game conducted in violation of State or local law.

Section 1.513-5(d) of the Regulations further defines Motto as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "Motto game" means any game of Motto of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "Motto game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

Section 44.4421-1(b)(1) of the Regulations defines the term lottery, which includes the numbers game, policy, and similar types of wagering. In general, a lottery conducted for profit includes any scheme or method for the distribution of prizes among persons who have paid or promised a consideration for a chance to win such prizes, usually as determined by the numbers or symbols on tickets as drawn from a lottery wheel or other receptacle, or by the outcome of an event: Provided, Such lottery is conducted for profit.

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Section 44.4421-1(c)(4) of the Regulations defines "Conducted for Profit" as, a wagering pool or lottery may be conducted for profit even though a direct profit will not inure from the operation thereof. A wagering pool or lottery operated with the expectancy of a profit in the form of increased sales, increased attendance, or other indirect benefits is conducted for profit purposes of the wagering tax.

Rev. Rul. 72-481 concerns what constitutes a wager using 'free plays' won in a 'Motto spindle game' only to the extent that the player assumes an additional risk. In the game being played, which is equivalent to a punchboard, a player pulls five spindles at X dollars per pull. These five pulls are taxable wagers. His first four pulls are losers, but on the fifth pull he wins ten free pulls. Under the rules of the game, he may not exchange free pulls for cash or merchandise, but he may use available free plays to pay for previous unpaid plays. There are two situations to consider; the first situation is that the player elects to use five of his free plays to pay for his five original taxable plays. Since no additional risk is involved in this use of free plays, it is held that such use of free plays does not constitute taxable wagers within the meaning of section 4401 of the Code. However, the second situation is that the player elects to play the first five of ten plays, so he is assuming an additional risk, so these would be taxable wagers within the meaning of section 4401 of the Code. With respect to the last five free plays, the player would not under any circumstances have had the choice but to play them or forfeit them, and since there's no additional risk, it is held that such use of free plays does not constitute additional taxable wagers within section 4401 of the Code. In order to exclude free plays from the tax on wagers, a taxpayer must maintain records that will establish that no risk was involved in connection with the use of the free play. If such records are not kept, then the Service will presume that all plays taken are taxable wagers.

Section 3.554(a)(3) of the State Motto Act Tax Rules defines an "Game" game as a game of chance played by the random selection of one or more individually prepackaged Game cards from a series of Game cards. Prize winners are determined by the preprinted appearance of numbers in a prescribed order, according to winning arrangements indicated on the reverse side of the card.

According to the State Administrative Code, Title 16, Part 9, Chapter 402, Subchapter C, Rule Section 402.300 the definition of a Motto Ball Draw is a pulling of a Motto ball(s) to determine the winner of an event ticket by either the number or color on the ball(s).

16 TAC §402.300(h)(6)

The State Administrative Code also defines an Event Ticket as...a Game Motto ticket used as event tickets that must contain more than two instant winners. Event ticket winner(s) are determined by some subsequent action such as a drawing of ball(s), spinning wheel, opening of a seal on a flare(s) or any other method approved by the Commission so long as that method has designated numbers, letters, or symbols that conform to the randomly selected numbers or symbols.

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business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead) shall be allocated between the two uses on a reasonable basis. Similarly, where personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses and similar items attributable to such personnel (as, for example, items of salary) shall be allocated between the two uses on a reasonable basis. The portion of any such item so allocated to the unrelated trade or business activities is proximately and primarily related to that business activity, and shall be allowable as a deduction in computing unrelated business taxable income in the manner and to the extent permitted by section 162, section 167 or other relevant provisions of the Code.

Treasury Regulation section 1.512(a)-1(f)(6)(i) provides guidelines for allocating certain types of expenses "For example, salaries may generally be allocated among various activities on the basis of the time devoted to each activity; occupancy costs such as rent, heat and electricity may be allocated on the basis of the portion of space devoted to each activity".

Taxpayer's Position:

Taxpayer has not stated a position at this time.

Government's Position:

Alternative Issues

Issue 1

At issue is whether "Game" is considered an exempt Motto game as described in Section 513(f) of the Internal Revenue Code (Code) and further defined in Section 1.513-5(d) of the Income Tax Regulations. (Regulations) The (Code) defines In general the conduct of Certain Motto games not included in the term "unrelated trade or business" and thereby exempted from the unrelated business income tax provide for under Section 511.

(Regulations) further defines Motto as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "Motto game" means any game of Motto of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "Motto game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

"Game" does not meet the term "Motto game" as described in the (Regulations)

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Taken right from the court case analysis of Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner. Game involves no random selection of numbers by a caller, nor does it require the player to participate in the game by covering the squares on his card that correspond to randomly drawn numbers. Rather, an Game player's participation in the game is wholly independent of any other's and requires only that he remove a Game to determine whether he has a winning card.

A Motto game by any other name is not a Motto game. Game is, for all practical purposes, a lottery. Game does not comport with even the preliminary requirement under Section 513(f) that it be "any game of Motto."

In the case of Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner, Game activity constituted unrelated business taxable income under section 511(a) of the Code. The Game game did not meet the definition of the Motto game defined by section 513(f) of the Code and section 1.513-5d of the Regulations. The net income derived from sales of Game games did not qualify for the exception from unrelated business income tax referred to in section 513(f) of the Code, and was considered unrelated business taxable income.

Issue 2

It is the Government's position that the CO-1 Trust failed to provide the organization, and the other exempt organizations in the CO-1, information under IRC Section 6013(d) needed to determine the amount of unrelated business income that the organizations should have reported on their Form 990-T. Treasury Regulation 1.702-1(a)(8)(ii) states that each partner must take into account the character of their share of any partnership income. Income from Games is unrelated business income whether or not the exempt organizations operate the gaming sessions alone or as part of a partnership. The character of the income does not change because of the organizational structure of the owners of the business. Unrelated business income prior to forming a partnership is still unrelated business income afterwards.

Issue 3

Only expenses directly connected with the carrying on of the unrelated trade or business and which is attributable solely to the conduct of unrelated business activities that are proximately and primarily related to that business activity, qualify as a deduction. Motto and Games are two separate activities. Motto is an exempt activity and Games are an unrelated business subject to unrelated business income tax. The expenses that are related to both activities (i.e. rent of the hall, utilities, etc.) must be allocated between the two using a reasonable allocation method.

According to Treasury Regulation section 1.512(a)-1(f)(6)(i), the time allocation method accurately reflects the salaries, wages and contract labor expenses, however, the time allocation method is not a reasonable method for allocating the rent, utilities, maintenance and repair, and

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other expenses. The gross receipts method reasonably reflects each activities use of the space. Therefore the gross receipts allocation method is a reasonable method to allocate the rent, utilities, maintenance and repair, and other expenses.

We have used the gross receipts method to allocate the expenses that are related to both Motto and Games. Please note that if you choose to use the time allocation method in the future for expenses related to salaries and wages, you will need to maintain detailed records of the time that each Motto/Game worker spent on the specific activity of either Motto or Games (or other if they receive wages for participating in any other activities), in order to allocate the wage expenses accurately between Motto and Games.

Conclusion to Alternative Issues:

Note: Conclusion to the Alternative Issue only applies in the event proposed revocation is not upheld.

"Game" is not considered an exempt Motto game as described in Section 513(f) of the Internal Revenue Code and further defined in Section 1.513-5(d) of the Income Tax Regulations. "ORG" is subject to Section 511 Tax on Unrelated Business Income for income it received from conduct of "Game Games".

Because "ORG" did not report the gross receipts from "Game Motto" on Form 990-T Exempt Organization Business Income Tax Return for tax year ending December 31, 20XX we have prepared an adjustment. In addition, because "ORG" has not filed the required Forms 990-T Exempt Organization Business Income Tax Return for tax years ending December 31, 20XX and December 31, 20XX, we have prepared substitute for returns. Explanation of the adjustments are included in the attached documents. (A-1 20XX through A-4 20XX for the year ending December 31, 20XX; A-1 20XX through A-4 20XX for the year ending December 31, 20XX and A-1 20XX through A-4 20XX for the year ending December 31, 20XX.)

If you agree to these adjustments, please have one of the officers of the organization sign on the separate report (Form 4549) and return the form to the contact person listed on the attached letter within 30 days of receipt. If you have any questions or additional information that could affect the tax adjustment, please contact the individual in the attached letter within 30 days of receipt.